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**PUBLIC UTILITIES COMMISSION**

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



January 2, 2003

TO: ALL PARTIES OF RECORD IN CASE RULEMAKING 01-12-009

Decision 02-12-055 is being mailed without the Dissent of Commissioner Carl W. Wood. The Dissent will be mailed separately.

Very truly yours,

/s/ CAROL A. BROWN  
CAROL A. BROWN, Interim Chief  
Administrative Law Judge

CAB:tcg

Attachment

Decision 02-12-055 December 17, 2002

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking on the  
Commission's Own Motion to Evaluate Existing  
Practices and Policies for Processing Offset Rate  
Increases and Balancing Accounts in the Water  
Industry to Decide Whether New Processes are  
Needed.

Rulemaking 01-12-009  
(Filed December 11, 2001)

**INTERIM DECISION ADDRESSING THE PROCEDURES FOR RECOVERY OF  
BALANCING ACCOUNTS EXISTING PRIOR TO NOVEMBER 29, 2001**

## TABLE OF CONTENTS

<b>Title</b>	<b>Page</b>
INTERIM DECISION ADDRESSING THE PROCEDURES FOR RECOVERY OF BALANCING ACCOUNTS EXISTING PRIOR TO NOVEMBER 29, 2001 .....	1
I. Summary .....	2
II. The Order Instituting Rulemaking.....	2
A. Pub. Util. Code § 792.5 .....	2
B. The Controversy.....	3
C. The Scope of the OIR and this Decision .....	4
III. Procedural Background .....	5
IV. Should the Commission Revise Existing Procedures for Recovery of Under Collections and Over Collections in Balancing Accounts Existing Prior to November 29, 2001? .....	7
A. Parties' Positions .....	7
B. Discussion .....	9
V. Comments to the Draft Decision .....	9
VI. Assignment of Proceeding.....	10
Findings of Fact .....	10
Conclusions of Law .....	10
INTERIM ORDER .....	11

## **INTERIM DECISION ADDRESSING THE PROCEDURES FOR RECOVERY OF BALANCING ACCOUNTS EXISTING PRIOR TO NOVEMBER 29, 2001**

### **I. Summary**

In this interim decision applicable only to Class A water utilities, we maintain the existing procedures for recovery of under collections and over collections in balancing accounts existing prior to November 29, 2001. We reserve for the final decision the issue of whether these procedures should be revised on a going-forward basis.

### **II. The Order Instituting Rulemaking**

#### **A. Pub. Util. Code § 792.5**

The Commission may permit a utility to change its rates to account for a change in costs (sometimes called an offsettable expense change, or an offset.) Upon receiving authorization to pass through the costs, the utility shall maintain a balancing account under Pub. Util. Code § 792.5,<sup>1</sup> reflecting the difference between actual costs the utility incurs and the revenue collected through the expense offset rate increase or decrease.<sup>2</sup> The Commission has traditionally authorized offset rate increases and attendant balancing account treatment to

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<sup>1</sup> Pub. Util. Code § 792.5 speaks in terms of a “reserve account.” (See the text of the statute in the footnote below.) A reserve account that has both revenues and expenses booked to it is also called a balancing account.

<sup>2</sup> Pub. Util. Code § 792.5 states: “Whenever the commission authorizes any change in rates reflecting and passing through to customers specific changes in costs, except rates set for common carriers, the commission shall require as a condition of such order that the public utility establish and maintain a reserve account reflecting the balance, whether positive or negative, between the related costs and revenues, and the commission shall take into account by appropriate adjustment or other action any positive or negative balance remaining in any such reserve account at the time of any subsequent rate adjustment.”

protect utilities from significant unforeseen expenses over which the utility has no control, such as the unforeseen increased expenses of purchased power, purchased water and pump tax.

### **B. The Controversy**

In the summer of 2001, several water utilities filed advice letters seeking offset rate increases to compensate for recent increases in the costs of purchased power which were not anticipated in the utilities' last general rate case. The Office of Ratepayer Advocates (ORA) protested the request to raise the rates of 20 districts of California Water Service Company (CWS), arguing that: (1) the Commission should not authorize offset rate increases for CWS districts because the utility is "over earning," that is, it is earning a rate of return greater than that authorized in the utility's last general rate case; and (2) the Commission should not permit water districts which are outside their rate case cycle to utilize balancing account treatment.<sup>3</sup>

In response, the Commission's Water Division drafted Resolution W-4294, dated November 29, 2001, which researches the history, rationale, and procedures for implementing offset rate relief and related balancing accounts. The Water Division staff concluded that: (1) ORA's protest raises serious issues of first impression warranting full Commission consideration; and (2) the Commission should consider ORA's recommendations on an industry-wide basis. The Commission agreed with staff's recommendations and issued this OIR.

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<sup>3</sup> According to ORA, districts that failed to apply for a general rate case when they had an opportunity to do so, either according to the Rate Case Plan adopted in Decision (D.) 90-08-045, 37 CPUC2d 175, or by other Commission decision, would be outside of their rate case cycle.

### **C. The Scope of the OIR and this Decision**

In the OIR, we evaluate existing practices and policies for processing offset rate increases and balancing accounts for water utilities and determine if new procedures or policies are needed. The OIR identifies the Class A and B water and sewer system utilities and ORA as respondents to written inquiries, and states that other interested parties and other water and sewer system utilities are not required to, but can, participate.

The OIR set forth issues to be addressed in an interim and a final decision. This interim decision addresses the following issues, the resolution of which only applies to Class A water and sewer utilities:<sup>4</sup>

“The existing procedure for recovery from balancing accounts is as follows: (1) Utilities, at their option, may request a surcharge once under collections reach 2 percent; (2) Otherwise, balancing account review and recovery of remaining balances are processed at the time of the district’s next GRC.

“1. Should the Commission revise its existing procedures for recovery of under collections or over collections in balancing accounts that existed prior to, and were suspended on November 29, 2001? Why or why not?

“2. If your answer to Part II, Question Number 1 is yes, what specific procedures should be implemented:

“(a) for districts that are within their rate case cycle and are not over earning?

“(b) for districts that are within their rate case cycle and are over earning on an actual or on a pro-forma basis?

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<sup>4</sup> This interim decision only applies to Class A water and sewer utilities because Class B water and sewer utilities use a recorded earnings test.

“(c) for districts that have stale adopted quantities because they are outside their rate case cycle.”

### **III. Procedural Background**

We received comments or replies on the interim issues from ORA as well as the following utilities: Alisal Water Corporation, Apple Valley Ranchos Water Company, California-American Water Company (CalAm), CWS, California Water Association, Del Oro Water Company, East Pasadena Water Company, Great Oaks Water Company, Park Water Company, San Gabriel Valley Water Company, San Jose Water Company (San Jose), Southern California Water Company (SoCal Water), Suburban Water Systems (Suburban) and Valencia Water Company (Valencia).

The March 11, 2002 Scoping Memo, as amended, confirmed the categorization of the proceeding as quasi-legislative, that hearings were not necessary, and that a draft interim decision would issue no later than September 13, 2002.

Some commenting parties believed that hearings were necessary prior to the Commission adopting an interim decision or that other issues should be included within the scope of this proceeding. The California Water Association believed that issues of possible increased risk from the OIR’s proposed changes, and how various risks affect a utility’s rate of return, should be considered in hearings. The Scoping Memo rejected the need for hearings, reasoning that “[r]e-adjusting a utility’s specific rate of return is not within the scope of this industry-wide proceeding. The appropriate rate of return is an issue for the utilities’ general rate cases. Furthermore, the question of how various risks affect a utility’s rate of return involves an inquiry into all relevant circumstances, not just one specific factor. Again, the appropriate forum for such inquiry is a

utility's general rate case, or other appropriate proceeding the Commission may designate in the future."<sup>5</sup>

The Scoping Memo also rejected San Jose Water Company's request for hearings because the company believed that consideration of water company earnings data during a selected five-year period is contrary to the Commission's ratemaking methodologies employed to set water rates in the first place. The Scoping Memo reasoned that the fact that the OIR sought information on earnings over a five-year period does not mean the Commission will employ any particular methodology or time period to establish eligibility for recovery of balancing accounts. Moreover, San Jose did not state any disputed issues of material fact for which hearings would be necessary.<sup>6</sup>

CWS requested hearings and workshops to explore the causes of over earning, arguing that over earning is not caused by the balancing accounts. The Scoping Memo explained that the cause of over-earning is not relevant to the OIR because the OIR does not maintain that balancing accounts cause the over earning. Rather, the OIR asks whether recovery of the balancing accounts should be eliminated or reduced in certain circumstances when the utility is over earning. The Scoping Memo also explained that, under the proposals being considered, the utilities would keep earnings above the authorized rate of return that are not attributable to balancing account recovery.

We affirm the rulings set forth in the scoping memo.

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<sup>5</sup> March 11 Scoping Memo at pp. 5-6.

<sup>6</sup> March 11 Scoping Memo at p. 7.



The Scoping Memo authorized workshops on one technical issue raised by San Gabriel Water Company, that is, with respect to the weather adjusted pro forma return earnings test, what is the proper calculation of the expense component of the means test. The results of this workshop are discussed more fully below.

The California Water Association, Great Oaks Water Company, and SoCal Water requested oral argument pursuant to Rule 8(d) of the Commission's Rules of Practice and Procedure. The Commission held oral argument on September 20, 2002 on all issues in this rulemaking, including but not limited to any draft decisions issued before the oral argument occurred.

#### **IV. Should the Commission Revise Existing Procedures for Recovery of Under Collections and Over Collections in Balancing Accounts Existing Prior to November 29, 2001?**

##### **A. Parties' Positions**

Many Class A and B water utilities and ORA responded to the interim issues. All the water utilities except for Valencia and Del Oro, believe that the existing procedures should not be changed. Valencia argues for procedures that are less restrictive than the existing procedures and Del Oro did not set forth how it believes the procedures should be changed.

ORA believes that the procedures should be changed to better conform to the original purpose of the balancing accounts, which is to afford water utilities within their rate case cycle an opportunity to recover unanticipated increases in electricity costs occurring between general rate cases, thus preventing financial injury.

In order to conform the operation of the balancing accounts to their original purpose, ORA recommends that balancing account recovery should be

capped for utilities within their rate case cycle which are not over earning, so that these utilities would be able to recover the amounts in the balancing accounts up to their rate of return. The remainder of the account would be disallowed.

If a utility is within its rate case cycle and is over earning according to a recorded rate of return means test, ORA believes that it should not be able to recover the balancing account. ORA believes that use of a recorded, rather than a pro forma (weather normalized) means test is appropriate for balancing accounts because, according to ORA, a balancing account recovers dollar-for-dollar expenses. If a utility is outside of its rate case cycle, ORA recommends that it should not be eligible for balancing account treatment until it submits a general rate case application and the Commission establishes new quantities. ORA believes that utilities that have “stale” adopted quantities from old general rate cases have been over earning for many years, and that the procedures should be revised to remedy this problem.

Many utilities have specific objections to revising the existing balancing account procedures. For example, Suburban, SoCal Water, and Valencia believe that the proposals to revise balancing account treatment are one-sided because the utility is required to refund over collections when it is under earning, suggesting that it is unfair to deny a utility recovery when it is over earning. Many utilities, including SoCal Water and CWS, believe that a change in procedure will cause additional risk, and that this OIR should address the added risk and impact on the affected utilities’ cost of capital by changing balancing account recovery policy. San Jose, CWS, and Suburban believe the utilities accumulated the accounts according to well-established procedure; thus, disallowing the accounts would violate the regulatory compact. Other utilities argue that the proposed revisions will deny the utility the right to a fair return on

investment, constitute retroactive ratemaking, and reverse an earlier Commission decision which did not require the water utilities to file general rate cases every three years.

## **B. Discussion**

The limited issue we address in this interim decision is whether the existing procedure for recovery of under collections or over collections in balancing accounts that existed prior to, and were suspended on November 29, 2001, should be changed. We reserve for the final decision the issue of whether we should change the existing balancing account rules on a going-forward basis. Also, contrary to several utilities' arguments, we are not constrained from applying new rules to accounts existing prior to November 29, 2002, under the doctrine of retroactive ratemaking, because we are not engaged in ratemaking here, and we are not constrained "that each and every act of the commission operate solely in futuro... ." (*Southern California Edison Company v. Public Utilities Commission*, 20 Cal.3d, 813, 816.)

Nonetheless, because many water utilities planned their operations based upon the existing rules, which have been operative for over 20 years, we find it inequitable to change them for balancing accounts existing prior to November 29, 2001. We therefore keep the existing balancing account procedures for processing accounts existing prior to November 29. The utilities may file for recovery of balancing accounts existing prior to November 29, 2001 according to rules as shown on page four of this decision.

## **V. Comments to the Draft Decision**

The draft decision of Commissioner Brown was mailed to the parties on August 29, 2002, in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Commission's Rules of Practice and Procedure. The following parties filed

comments or replies: ORA, California Water Association, San Gabriel Valley Water Company, and Suburban. We make a substantive change to the draft decision, and do not revise the existing procedures for recovery of under collections and over collections in balancing accounts existing prior to November 29, 2001. We also make minor corrections to the text to improve the discussion and to correct typographical errors.

## **VI. Assignment of Proceeding**

Commissioner Geoffrey Brown is the Assigned Commissioner and Administrative Law Judge (ALJ) Janet Econome is the assigned ALJ in this proceeding.

## **Findings of Fact**

1. Many Class A water utilities planned their operations based upon the existing balancing account rules, which have been operative for over 20 years.
2. Based upon the existing record, we find it inequitable to change the existing rules for balancing accounts existing prior to November 29, 2001.

## **Conclusions of Law**

1. The rulings in the March 11, 2002 Assigned Commissioner and Administrative Law Judge's Scoping Memo should be affirmed.
2. We do not revise our procedures for recovery of balancing accounts existing prior to November 29, 2001.
3. Utilities requesting recovery of existing balancing accounts prior to November 29, 2001 shall file, within 90 days from the effective date of this decision, advice letters requesting recovery pursuant to the existing balancing account procedures.

4. Because we wish to achieve closure regarding the balancing accounts existing prior to November 29, 2001, this interim order should be effective immediately.

**INTERIM ORDER**

**IT IS ORDERED** that:

1. We maintain existing procedures for Class A water and sewer utilities to dispose of balancing account balances accrued before November 29, 2001.
2. Utilities requesting recovery of existing balancing accounts prior to November 29, 2001 shall file, within 90 days from the effective date of this decision, advice letters requesting recovery pursuant to the existing balancing account procedures.
3. The rulings in the March 11, 2002 Assigned Commissioner and Administrative Law Judge's Scoping Memo should be affirmed.

This order is effective today.

Dated December 17, 2002, at San Francisco, California.

HENRY M. DUQUE  
GEOFFREY F. BROWN  
MICHAEL R. PEEVEY  
Commissioners

I dissent.

I reserve the right to join Commissioner Wood's dissent.

/s/ LORETTA M. LYNCH  
President

I will file a dissent.

/s/ CARL W. WOOD  
Commissioner

R.01-12-009 COM/GFB/tcg

[Commr. Wood's Dissent to D0212055/R0112009](#)